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POLITICAL CHOICES FOR MUNICIPAL BONDS

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POLITICAL CHOICES FOR MUNICIPAL BONDS

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Dedication

This thesis is dedicated to my grandparents, Guy & Roseanne DiPietro and Joseph "Bucky" & Lucille Finello – may they all rest in peace. Thank you for all that you did.

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And finally, I'd like to thank you for reading this. I hope that it provides some inspiration and instruction.

Abstract

POLITICAL CHOICES FOR MUNICIPAL BONDS

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Municipal bonds represent an important but understudied source of funds for governments. This paper seeks to shed light on the previously hidden political choices that influence the choices of governments to pursue bonds, as well as to act as a springboard for future bond research.

Table of Contents

It is no secret that the government requires money to run. Nor is it a secret that the federal government has two main sources of funding – money taken from taxes and fees, and money borrowed from people, organizations, and nations in the form of government bonds.[1] The states and local governments add an additional source of funding to this list, of course – they receive transfer payments, money given directly from the higher levels of government to cover specific projects or types thereof.[2] However, the literature of public policy, public administration, and political science has historically understudied the borrowing powers and behaviors of the lower levels of government, even in recent years; much of the work done on public finance has been an aspect of economics, and fails to focus on the political choices by decision-makers. While the fields of economics and finance study the use of bonds as investment instruments, they fail to analyze the decisions that politicians in power make regarding the decision to fund projects by borrowing money against the future success of the government in question.

This paper aims to collect and disseminate as much information, both from existing information and from the author's own authority, as it can regarding the realities of the state and municipal bond[*] – its purposes, its limits, and comparisons to other options, such as taxes. Beyond that, it seeks to lay the foundations for future research into bonds, whether by the author or the efforts of others, by fortifying the thin body of research present on the matter.

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[*] It should be noted that municipal bonds are a term used to describe all local government bonds, regardless of the government issuing the debt; non-municipal local governments, as described below, are still considered to issue "municipal" bonds.

It also seeks to begin addressing a set of specific questions, including the question which first inspired this project – Where is the political discretion for lawmakers in deciding to use bonds over tax raises? Where are the decision points, and where is the flexibility for the policymakers in the process and in the results of passing bonds versus taxes?

The Census Bureau estimates that all local governments† in the United States collected $900 billion in revenue from their own sources in 2011. The state governments collected an additional $1 trillion in revenue.‡ Much of this money is spent providing goods and services to the American people; however, the states also spend $108 billion paying back the interest held in general debt – that is to say bonds – of which the local governments owe 60%.[3] The $60 billion paid by local governments exceeds the annual budget of any single state except for Illinois, New York, and California.[4] That same year, over $118 billion in new long-term, tax-exempt bonds were also issued by state and local governments, ranging from Vermont's $87 million in bond sales to New York's $14 billion in bond proceeds. In past years, these totals were even greater; in 2007, over $200 billion in new tax-exempt bonds were issued by state and local governments.[5]

As a percentage of available money, bond proceeds are relatively rather small compared to tax revenue in a given year; the total amount of bond proceeds in 2011 was equal to 5% of the money raised by taxes and charges. However, this was just one year. Debt builds over time, as new principals and new interest are issued year after year.

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† Governments subsidiary to the states, as detailed below.
‡ This excludes the $554 billion granted by state and federal governments to local governments, as well as the $573 billion given to the states by the federal government. This also excludes bond proceeds, which are not considered revenue, as such proceeds are obligations to other payers as opposed to unilaterally-collected items.

According to one estimate, over three trillion dollars in municipal bond debt remains outstanding as for July 2014,[6] a figure almost equal to President Obama's federal budget request for fiscal year 2014.[7] We have to ask why governments are willing to put themselves into so much debt when they could theoretically just dedicate tax revenue; why are they burdening their future populations for projects undertaken in the present.

Bonds provide a similar type of flexibility to cities and other local governing units. Bonds often can only be used for particular projects – a city cannot sell a bond to pay for employee benefits, but can sell bonds to buy new fixtures and equipment for an office. However, are bonds being used to avoid spending regular revenue – tax money – on those other projects, opening up additional funds for purposes that cannot be funded by bonds? What choices are made, and by whom, regarding these decisions? And what are the consequences of the choices these parties make?

Local Governments

For most people, local governments in American federalism refer to the counties and the cities of the United States. This is accurate, but incomplete. In fact, lower level governments, though they vary from state to state, take a great many forms and deal with a great many different areas of governance.

Cities and counties, which are often responsible for police, utilities, and transportation, as well as public works and emergency medical matters, are the best-known forms of local governments. However, local governments are any "entity… [possessing] existence as an organized entity, governmental character, and substantial autonomy." This means they must be possessed of "some corporate powers such as…

the right to sue and be sued, have a name, make contracts… and the like," must act in a fashion recognized as governing, most importantly providing services to the public or being accountable to the populace under the jurisdiction of the entity, and have "fiscal and administrative independence" to a notable degree (though they need not be completely self-sustaining, as even the states rely heavily upon the federal government for money, and must follow the extensive national rules set for them).[8]

In addition to county, municipal, and township governments,[§] two other types of government exist– independent school districts (ISD), and special-purpose governments. Although not universal, independent school districts exist in the majority of states,[**] and numbered 12,880 as of the 2012 Census of Governments.[9] These districts can be associated with a particular geographic area defined by the boundaries of cities or counties, of course, but the districts themselves have an authority considered separate from the local government, and ostensibly do not have to answer to local authorities with regards to how the schools are run.[10]

Although the concept of special-purpose governments is universal across the states, the various functions that can fall under these districts are not. Each state has the right to organize such one-purpose or limited-purpose districts, which can handle a common function usually regulated by a local entity which the state has placed under a separate authority (i.e. municipal utility districts or transit authorities), or could focus on

[§] Township governments do not exist in the South and West regions of the United States, as defined by the Census Bureau. Connecticut and Rhode Island do not have counties.

[**] Maryland, North Carolina, and Alaska do not have any independent school districts; they have dependent schools based on the municipal or county in question. Hawaii also has no independent district, and operates a single state-run school system. Sixteen states have a mix of the two types, ranging from Virginia, with one ISD and 135 dependent school districts, to Louisiana, with one dependent district and 69 ISDs.

a novel purpose conceived of in that state (i.e. mosquito abatement) which is not traditionally a government task, but which the state chose to involve itself in for the betterment of the people. These districts are also the most varied in geographic control; although some serve areas based on cities or counties in the same fashion as local ISDs, some of them are in charge of a larger, less defined region.[11]

We require these definitions because local governments can and often do receive differential treatment based on their type and size. A narrowly-tailored special district may have more or stricter restrictions under the law than larger multi-purpose governments such as cities and counties.

Data on Bonds

Major works on public administration, urban politics, and political science barely mention bonds, if they do so at all. A 2001 work on comparative public administration does not mention bonds, even with regards to national issues.[12] The most recent edition of the *Urban Politics Reader* mentions bonds as an option for satisfying the "imperative for an urban regime [to secure] sufficient revenues,"[13] but no details are given regarding the actual effects of bond purchases on political fortunes or on practical realities of urban politics. Another major 2007 work similarly excludes mention of debt or bonds,[14] and the regularly-updated online *Concise Oxford Dictionary of Politics* has no entries for "debt," "bonds," "municipal bonds," or other related terminology.[15] The state of data available regarding bonds and bond issues may contribute to the neglect of the issue.

The IRS provides one major source of bond information. Given the tax-exempt status of many types of government bonds, the IRS keeps track of bond issuances, and provides aggregate data regarding the different types of bonds, divided by state and by purpose for the bond; this data includes both the number of issuances,[††] as well as the amounts issued overall. However, the data's organization only focuses on the states'[‡‡] aggregate principal amounts issued in a given year, without aggregating principal amounts across time, interest due in a given year, or disaggregating the data between the state and local governments. In addition, the data only dates back to the 1990s, and in many cases includes aggregation of principals across many years; prior to 2005, at least some, if not all, of the data comes as a total of all bonds issued in a multiyear timeframe, making it difficult, if not impossible, to distinguish cross-year trends prior to that date.[16]

The Municipal Securities Rulemaking Board, a subsidiary agency to the Securities and Exchange Commission, runs the Electronic Municipal Market Access (EMMA) online bond database, which presents a great deal more detail about specific bonds themselves; it provides information about any and all outstanding bonds from all government issuers across the nation, including issuing dates, rates, and trade activity, as well as any official statements issued about the bonds, primarily as a resource for investors and potential issuing governments. As a result of the investor-based focus, the site lacks detailed classifications for each type of issuer; that is, there is no way to search simply for school districts, special districts, or county governments if one was so inclined. The primary search feature works off of the issuing government's name, likely due to the sites professed focus on providing information to investors (and to issuers who

[††] An issuance being a single government's issuing of bonds for a single purpose, not the number of bonds issued overall.
[‡‡] Including the local governments in a given state.

are curious as to the financial conditions of comparable governments), and the advanced features only offer limited options for filtering specific types of data; nor does the sight provide any aggregation mechanisms. Finally, the site appears to either not keep records once the bond has been paid off, or else lacks data from before a certain point; especially if the latter is the case, using the individual entries to build a research database may well leave holes in the data that can thwart analysis. Having said that, the EMMA database provides comprehensive information for those who wish to study specific issuers' current debts, either academically or as an investor; individual queries such as these will find EMMA to be a highly useful tool.[17]

Some states provide better bond information than others; however, Texas is the only state to compile its own comprehensive database for both state and local bonds. The Texas Bond Review Board (BRB) maintains an in-state database similar to EMMA on bond issuances divided by government. Unlike EMMA, the database can be broken down by government type; one can easily find out how much money the school districts or city governments owe. However, it runs into a similar problem regarding past entries – bonds that have passed their maturity date by more than a year, or which have been otherwise paid off, are removed from the system; thus, there is no way to use the database to create a complete picture of bond issuances in state history.[18]

Private sources provide other forms of information; investment companies advertising bonds, as well as financial analysts, provide sale prices, interest rates, and other useful data to investors. However, that data is aimed just there – at investors. No known company maintains a comprehensive list of publically available bond information.

Think tanks and other analysis sites provide summary statistics about aggregate bond figures, such as the total outstanding bond debt,[19] but no site provides specific information as well as EMMA or the Texas BRB.

Quantitative data is not the only aspect of bond information that lacks a complete centralized and standardized database; no agency maintains a comprehensive list of state and local bond policies. While the MSRB does maintain its national rules, the MSRB site lacks information about how local policies vary from state to state; to understand state policies, researchers must delve into state constitutions and statutes to understand what policies and rules each state abides by.[20] This, in turn, makes the bond process virtually opaque to those outside of it – while voters see a piece of the process in their elections (as described below), insight into the pre-bond process becomes scarce and diffuse. No known academic insight into how decisions to pursue bonds exists.

Similarly, comprehensive data on how each state regulates its local governments remains lacking. Although the Census Bureau provides information about the different local governments across the country, updated every five years, the report provides only general information about the powers and purposes of each type of government, and fails to address specific details regarding tax and bond limits. This makes it difficult to generalize about the options available to specific types of governments.[21]

All of these sources provide valuable information; however, many are also designed to service investors, not political scientists or policy analysts, possibly contributing to the lack of non-economic research into the politics of bonds, and the political decisions that influence whether to raise money through bonds, or to raise it through taxes. As a result, political research into bond issues cannot rely upon specific quantitative data; instead, it must rely on a qualitative approach that determines where in the process lawmakers generally have discretion and decision points.

Bond Qualities

Although states can have special classes or qualifications for bonds, there are a few commonalities between the various types of bonds issued by states and municipalities. First of all, bonds have some federal regulation: the Municipal Securities Review Board acts to qualify advisors and underwriters, and reports information on local and state government debt to investors through their EMMA database;[22] the IRS makes sure that the governments spend the money they raise on public projects in a certain time-table.[23] However, each state has the right to handle most bond issues as it sees fit; no federal laws require bond elections, and so long as the bonds operate within the bounds of the IRS laws, the federal government largely stays out of state and local public finance issues. The exceptions are private activity bonds – issued by municipalities and states to raise money for projects undertaken with a non-government profit-making entity – which are taxable at the federal level,[24] and tax credit bonds, which are generally issued based on federal legislation and act as a federal income tax credit rather than a direct investment (though the states affected are actually issuing the bonds).[25]

Each state has some form of bond regulation, usually as part of the constitution. In the case of Texas and Delaware, all public security issuance must be approved by the Office of the Attorney General, and the information on these approvals is collected by the Texas Bond Review Board, an agency nominally consisting of the Governor and several other high ranking individuals in Texas government who prepare annual reports regarding local debt. On a more passive level, state laws in Texas restrict bond issuance to an extent by setting a limit on the amount of property tax that may be used to fund bond repayment. However, within these constraints, those bodies which can issue bonds are able to issue them for any public works project they feel necessary, and all other states have similar policies regarding how bonds can be used. [26] States such as Alabama[27] and Illinois allow for local governments to seek bonds via election, but have very specific rules on how much debt a given government can accrue.

Though each state has its own policies, the IRS has determined three main specific classes of bonds. Tax-exempt bonds are both the oldest and the most common. These bonds fall into two categories: the more common, referred to as general obligation or "GO" bonds, are issued in order to raise capital for projects within a specific issue area, such as education or transportation; and the less-commonly used certificates of participation (COP), where a government "leases" a capital project using existing revenue, as opposed to allowing any new taxes, and which can be canceled at any time.[28][§§] The bonds act as a loan made by the purchaser, with the promise that it will be worth more in a specified length of time than when it was purchased, and that the investment and interest will be free from federal taxation.[***] The money raised in the sales falls into two categories: new money is used towards a novel project (i.e. newly

[§§] Though no federal laws require elections for any bond, most states require that municipal GO bonds undergo an election before sale; COPs can be issued without elections, as they do not raise taxes and are paid from pre-existing revenue, and because they can be discontinued if the government allows it.
[***] The Federal Government does have the Constitutional authority to tax bond interest payments, according to the 1988 case *South Carolina v. Baker*. However, federal law has codified the tax-free nature of tax-exempt bond interest. Each state is allowed to regulate such interest as taxable income for its own purposes, if its legislature wishes.

announced school renovations); refunding bonds, on the other hand, appear to be used to help pay back older bonds which are coming due (similar to using one credit card with low interest to pay off another with higher interest, or more accurately, similar to refinancing a loan under better terms). [29]

The second category of bond is the private activity bond, mentioned above. These bonds can vary in purpose as well, but typically involve some sort of private enterprise or endeavor, which the backing city or state nevertheless considers beneficial to the community;[30] they also can be used in situations where there is a public-private partnership.[31] The interest rates on these bonds are taxable, but the rates tend to be higher; in an ideal situation for the investor, the bonds will pay back as much as, if not more, than a tax-exempt bond of similar value over a similar time. [32]

Finally, governments occasionally issue tax-credit bonds. Unlike tax-exempt and private activity bonds, which are intended to provide interest payments upon the maturation of the bond, tax credit bonds allow the bearer to claim a specified value from the bond as a tax credit every year they hold the bond. These bonds are relatively novel, however, dating to only 1997, [33] (compared to municipal bonds, which were first issued in 1812 by New York City)[34] and are the smallest category, both in number of offerings (less than 200 separate offerings in 2010) and in dollar value (only $1 billion in 2010, compared to the $420 billion in tax-exempt bonds the same year).[35] They also are the most limited, as each bond relates to a highly specific activity, such as school construction, forest conservation or renewable energy, instead of more general issue areas such as transportation. These also are tied into the federal government, which grants permission to issue tax credit bonds (though in theory states could issue them independently to exempt individuals from state income tax, as well).[36]

Governments may have only one option for types of bonds to use, or may possess several; however, all bonds of a given type function similarly regardless of the issuer. A general obligation bond issued by a school district does not possess unique characteristics compared to a GO bond from a city with comparable taxing policies; state bond issuances are likely larger than an individual city's issuances, and states and cities obviously have different sizes of tax bases, but a state transportation bond and a local transportation bond will ultimately function to accomplish the same thing, and will ultimately be paid off the same way.

Choices Between Bonds

The types of issuable bonds presents one form of choice to lawmakers – depending on the circumstances they find themselves in, they may have one or many options to raise capital through bonds. Thus, the choice for governments seeking debt for capital projects comes down to which type of bond would be most appropriate.

In most situations where a private entity makes a profit, or where revenue is generated, revenue and public activity bonds are usually the only option. However, in the event that a municipality somehow had the choice between revenue bonds and GO bonds, which option would they pick? For example, in the 2011 Central Health bond offering, part (but not all) of the bonded project provided revenue to a private entity which co-owned the facility being financed; if the hospital district had the choice to work with a partner and seek the revenue bond, or to use the same amount of money in a general obligation bond and open up or renovate their own hospitals only, why would it pick one or the other?[37]

Assuming such a situation could exist under the law, the ultimate answer likely depends on three factors: how much additional money the private entity could provide, how much revenue the private portion of the bond would generate, and how popular the project is. In the first place, if a private entity working on the bonds is willing to stake a certain amount of money, the extra revenue may entice the government to work with them to fund the project, even though the bonds will be taxed and thus may be less appealing to investors. Secondly, the revenue that the bond's projects generate affect the likelihood the bond can be paid off in time; if the projected revenue edges too close to what the bond would need in order to pay itself off, GO bonds may prove to be a more appropriate choice; this is especially true if the bonds can be made for a shorter term, meaning that any tax increases associated with the bond could be redirected in the future.

Finally, and most importantly, governments must take into account popularity of the project being bonded. This issue also comes up in the choice between certificates of participation and general obligation bonds; although the latter has fewer funding sources (since taxes cannot be raised to pay off COPs), according to financial advisors, COPs provide funding in situations where the projects are unpopular with voters, and thus stand a high chance of losing in an election. Prisons, administrative buildings, and other projects voters see as unnecessary or even dangerous, but which government see or know to be necessary, can be built without public participation with non-voting bonds.[38]

Governments also must decide how much debt to take on at a time, and what the time-table for paying the bonds back will be. With regards to the first, the decision comes down to whether or not the government should sell all available bonds at once or not, which in turn largely depends on the state of the market. Interest rates across bonds tend to vary consistently; a low-grade bond may have a higher interest rate than a highly-rated bond, but the same type of bond will generally see its interest rates rise or fall at the same pace, meaning that all municipalities should have similar sale prospects, time being irrelevant.[39] Given this, it generally behooves a the government to sell when interest rates are low; a difference in one percentage point of interest can cost the city $10,000,000 in additional interest on a fifteen-year bond. In situations where the rate is higher than the government would like, the government is more likely to sell bonds over time as needed, in hopes that the rates may go down, or at least that the delay will prevent the debt from coming due all at once, giving extra time to pay it off.

Governments also have control over the duration of the bonds, which can be an important tool in deciding how the debt affects the area's economic prospects. Sometimes, as in the case of Central Health, bonds are structured to come due at the same time, fifteen years after issuance. This may be as a result of the hospital district's financial health, or may be a factor of the "simple" structure of the project in question.[40] Alternatively, a complicated school bond or other multi-layered issue may stagger the debt over many years; according to one school trustee involved in a recent bond election, certain items are funded by different length bonds, depending on the life of the item and the need for funds. A thirty-year bond may be ideal for a long-lasting school structure, but would be less appropriate for a set of computers that will likely be obsolete and require replacement in eight years.

The State of Municipal and State Bond Debt

Nationally, almost sixteen thousand bonds tax-exempt were issued in 2010 alone by states and municipal divisions, which raised a total of $217 billion dollars.[41] Over half of the money was allotted for refunding purposes.[42] The IRS divides the remaining new money bonds into nine categories. Seven of the categories are specific issue areas: education, health (including hospitals), transportation, public safety, environment, housing, and utilities.[†††] Area 8 includes anticipation notes, short-term (one year maturation period) bonds which are issued to cover high start-up costs and which are paid out of the following year's taxes, bonds, or general revenues. The final area is a miscellaneous category, in the event that a bond did not clearly fit into the above areas, or that the bond's issue area was not clear (either due to a lack of reporting or due to falling into multiple issue areas).[43]

As previously mentioned, the state and local governments paid over $100 million in interest and returns on principals in 2011.[44] However, the vast fluctuations in interest rates across time make it impossible to tell how principle was outstanding that year; average interest rates in the last six years alone have varied from 2.5% at the beginning of 2013 for highly-rated bonds to nearly 8% for lower rated bonds in 2009. In addition, these figures only reflect 20-year bonds issued in this time; longer or shorter terms may carry adjustments to the interest rate to incentivize bonds of different length.[45]

[†††] These are federal classifications. The states and cities may use their own categories, but most bond funding falls into one of these seven areas.

How Are Bonds Passed?

Certain types of bonds require no voter approval; other types of bonds may, depending on state and local laws. Understanding the process by which these types of bonds come into being helps us understand the choices lawmakers have in passing bonds. In both cases, the process, on the surface, seems relatively simple.

All bonds start with the governing body in question. It is up to that body, be it a city council, school board, or state legislature, to determine whether or not a bond is a necessary and proper instrument to secure additional funding beyond taxes, fees, and fines already in place. From there, the process diverges depending on the type of bond, or, rather, the rules in place for the type of bond being debated. For those bonds that require only approval from the government, such as revenue bonds and GO bonds in specific locations (generally only the states, though some local governments have more freedom in this area), the government can choose to pass them without consulting voters, giving some of these choices more attractiveness.

For GO bonds in most governments, approval of the bond legislation leads to the bond being placed on the ballot, either in the next election period where matters pertaining to that government would be voted upon, or with a special election. For example, Georgia law sets the dates that special elections can be held.[46] Texas' Election Code similarly sets dates, but has a number of override options that can allow for alternative election dates.[47]

The dates available for elections affect the choices open to lawmakers, as different electoral situations provide different conditions for a bond's victory. A more conservative crowd in odd-year elections may favor fire and police bonds, but limit the success of other issues; however, even-year elections tend to be more crowded, not only with bonds but with other issues as well, meaning that some items may receive "no" votes due to choice fatigue, especially those that are placed later on the ballot.[48] Similarly, the timing of a bond election within a year, if such an option exists, affects the electorate, as well. If the state allows bond elections to occur with primaries, this can lead to skewed electoral support, as turnout is lower and tends to be more partisan, leading to more extreme reactions to a particular proposal.[49] Knowing the current trends for elections may change when a particular election is scheduled, if the option is available to a lawmaker.

Once the bond is approved by either the governing body or the voters, the bond is sold, and the money is put to work on projects. Governments do have a certain amount of flexibility in determining how the bonds are sold (i.e. all at once or over time), and in determining the length of a given bond's maturation period (allowing them to sell bonds for smaller projects so that they can come due at a more appropriate time).[50] The selling government then arranges to pay back the bond over a set length of time using tax dollars.

The Process, Revised

The above process portrays how bonds are brought to fruition: a ballot measure is proposed; a ballot measure passes; the government receives proceeds that it must later pay back. However, ballots only have so much room; they cannot place the entire text of the bond offering on the pages, and thus most voters only see a summary of the bond, including the principal amount and the general purpose. However, what goes into a new bond election before it reaches the ballot?

A given local government does initiate the formal process of determining whether or not to offer a bond election; however, this process starts up to two years before the election would take place. In the cases of governments that have multiple areas of responsibility – such as a city, which can seek bonds on multiple subject matters such as housing or transportation – the government's lawmakers also must decide what topics to support with a bond; in single issue area districts, such as independent school districts, the bond can be structured to include any desired education-related capital expenses. After the decision to seek a bond is made, the given governing body – a school board, city council, board of trustees, or other organization or authority based on the government's structure – then has to determine how much to seek in the election. To do so, that board must solicit funding requests from those that would be affected by the bond. This can take many forms, as well, from public polling to asking those in charge of a particular unit (such as a hospital department head or a school principal) to list their individual needs. In addition, governments must consult the contractors that would be responsible for completing such developments, in order to acquire cost estimates, design plans, determine the likely placement of new construction, and other related information vital to the construction.

All of this information comes at a cost –the money collected by architects and other cost estimators might not be refunded to the city if the election fails, which can affect how detailed a bond package is before an election; governments may choose to limit pursuing complete or fully detailed plans (so much as the law provides) until a bond has passed the voters, in order to save money.[51]

When the data in question has been gathered, as a best practice, the governing body designs a “blueprint” of how the money to be raised should be spent by issue priority. This does not expressly have to happen in every case; however, these blueprints allow for a firm understanding of what changes or developments need to be made, and allow the government in question to make sure that they seek the right amount by analyzing the government’s needs, and are generally considered a best practice.[52] This also allows a given district to make sure that all the changes desired by those involved are actually necessary and desirable, and that the process assigns proper importance to given issues.

Once the actual plans have been drawn up, districts employ special firms to examine the wish lists and design the actual bond packages that will be offered, including any additional funds necessary to act as a “cushion” against overruns. These packages also outline the sale patterns of bonds, determining how quickly to sell them and the denominations (both in dollar values and in the maturation period) based on the money spent on particular improvements, the performance of past bond sales, and the government’s current debt situation and repayment rate. Again, these financial advisors come at a cost, which may or may not be refunded or recouped if the bond fails (depending on the negotiations between the parties). These plans also take into account the window over which the funds will be distributed. Only after these plans have been drawn up does the governing body call for the election in question.[53]

From there, the process does continue largely as described previously – after the call for an election (if one is required), a period of public response opens up, allowing for campaigns for and against a bond. Unlike with candidate positions, the bonds cannot be altered based on public demand; also unlike candidates, the body that initially called for an election may not be able to defend it themselves. Laws vary from state to state, but in many cases the originating government cannot distribute material or make political communications in support of or against a proposed package; nor can any member of that board speak out for or against a bond package in an official capacity (as a private citizen, they may make such comments on an individual basis, but they cannot claim their membership in that government in the process). The governments so limited can distribute informational material that expressly explains what the bonds will be used for, but cannot make statements that endorse the election; special law firms are retained to examine the language of any material or communication distributed in such cases.

After a successful election, the bonds are distributed as per the plan, though many plans do allow for some flexibility if the situation has changed since initial development. At this point, the state employs an underwriter, who may have been chosen before the bond sale. The underwriter assumes the financial risk for government and purchases all the bonds offered at designated times, then distributes the bonds to investors.[54] The interest rate plays a key role in such sales, as it determines whether all the bonds are sold at once (if the rate is low), or whether the bonds will be broken up and sold piecemeal as needed. Once the bonds are sold, the funds are allocated as per the plans' priorities, until the money either runs out or the plan is fulfilled.[55]

On the surface, this version of events seems to reflect a similar, if more detailed, process as the one described earlier. However, these details, which the public must actively seek beyond the voting booth, actually open all-new understandings of what bond sales mean to local governments, and how much flexibility they may provide. In fact, in conjunction with other research on various stages of the process, bonds may provide flexibility for governments, but not fungibility. Bond sales only provide that as an afterthought.

As mentioned before, bond packages include a certain amount of contingency funding, in the event that a particular project runs over estimation for any reason. The constitutional provisions in a given state may allow for left-over funds to be used for similar purposes at a later date, if the initial package has been met; for instance, if a new school was completed with exactly 100% of the budget, the leftover contingency money could be used by for other educational capital expenditures. This is not always the case – in California, the state's Fourth District Court of Appeals ruled that elections passed under a 55% threshold[‡‡‡] cannot use money for projects not listed on the bond offering[56] - but most state and local governments can use money for general purposes after fulfilling any specifically listed projects (and the language in both bond offerings and ballot measures often include clauses that allow for flexible spending). Thus, an efficient-enough project leaves room for spending on other matters, and the choice to proceed with a bond may depend on the reliability of particular contractors.

‡‡‡ California allows for several different types of voting thresholds for different purposes, the three most common being simple majority, 55% of voters, and 2/3 of voters.

However, several key limits prevent this funding from being spent arbitrarily, and in fact prevent it from being raised arbitrarily, as well. The largest such limit comes from arbitrage laws, a set of federal tax codes that regulate when a bond can be considered tax free. Federal law largely does not concern itself with the design and implementation of bond sales; however, given the nature of general obligation bonds to be tax-exempt, the IRS and Congress have instituted a set of rules and laws to determine under what conditions bonds are not subject to taxation. These rules are another reason that bond lawyers and investment firms play such a crucial role in the process; if bonds were not tax exempt, there is a good chance that would-be buyers would rather invest in other matters. One major component of the laws regulates how much money raised from a bond sale must be spent by a particular time. As a rule, 85% of the money raised in a bond sale must be spent within five years. [57]

This number is key. Arbitrage laws make no mention about contingency funding; they do not prevent localities from including it as part of a package, but neither do they formally recognize it as somehow exempt. That means that a particular municipality or local government can seek, at most, to make fifteen percent of the total bond sale a "slush fund" from which they can draw money for other capital projects in the long run without another bond election. And, that number requires exact expenditures on the bonds' stated purposes, without overrun, and (in the event of an overly-efficient contractor) enough other projects to pay for in the short run in order to prevent the bond's tax-exempt status from being removed.[58] Thus, bond-offering governments must consider how much construction they reasonably can perform in a given timespan when constructing a bond-package; projects that are not expected to begin within five years, or whose construction time will take them past the five-year mark from the bond sale, may remain off the table until a later year, when a new bond can be passed.

This does allow some room for leftover bond money to sit and wait until the government needs it; should any of the contingency funds not be necessary, they can be held onto until spent so long as 85% of the original bond was expended, as per federal law. In the event of a future failed election, leftover bond money can be used to accomplish some of the smaller requests of a given bond, so long as it falls in the same purpose (e.g. you cannot use transportation funding on a low-income housing project, but you can use it to fix potholes that a large transportation bond would have fixed). However, that also means that the contingency funds may not be available as a "slush fund" should the project go over budget – the original purpose of the contingency funds is to act as a buffer in the event the projects need more money than expected, and thus must first be dedicated to those original projects before they can be spent on something else. In extreme cases, a bond's funds may run out before the project is even complete; though no cases of this were located, lawmakers obviously feel some concern about this prospect, or contingency funds would not be necessary in the first place.

Also, there is a question as to how fungible the money truly is. This paper works on the idea that money is fungible when one source earmarks funding for a particular project, allowing general funds to be redistributed to other purposes. The fungibility of bonds must take into account how tax revenue can be spent at a local level. Local budgets consist of two components – a portion used to pay off bonded debt (including principles and interest), and the maintenance and operations (M&O) component, which pays salaries and handles all other expenses.[59][60]

Tax money can be put towards any purpose in the M&O; unless a law passing a new tax specifically earmarks that tax money for some specific purpose, tax money can be allocated to any project. Bond proceeds, conversely, must be put towards capital expenditures. One cannot pay salaries with bonds, or buy supplies intended to be used up such as paper or printer ink.[61] However, in the absence of bond money, it is the M&O funding that provides for smaller capital goods, on a "pay-as-you-go" basis – replacement computer and printer purchases, capital repairs and replacements, and other such items all drain tax dollars. A bond can provide for new computing equipment, and while it cannot be used to repair malfunctions, it can be used to replace existing infrastructure with new items that will malfunction less frequently than the old unit.

Thus, bond funding can be somewhat fungible in the long run in particular circumstances, and the presence of funds from a bond can provide fungibility in the M&O budget. However, lawmakers cannot fully rely on the possibility; though knowledge of contractors and situations may allow governing bodies some idea as to how much will probably be left over from a successful bond whose projects are all completed, uncontrollable factors such as the weather and the price of supplies can lead to cost overruns that prevent the accumulation of excess bond funding. Further, they cannot count on bond elections passing automatically; thus, they cannot rely on money from a bond alleviating the burden on their budgets caused by old or damaged equipment.

Why Policymakers Use Bonds Instead of Taxes

One of the questions raised earlier in the paper dealt with the question as to why the local governments choose to sell bonds when they can instead tax their constituents. Certainly, there are political concerns, but the mechanics certainly exist to raise taxes if necessary. However, the reality of the situation is that, while taxes are certainly more flexible than bonds in what they can be used for, there are other limits in place that keep tax money from being a panacea to government spending woes.

When looking at local governments as a whole – city governments as well as other local bodies such as school boards – property taxes make up a large portion of revenue. At both the city and state level in 2010, property taxes made up an aggregate 35% of all revenue, with sales tax coming in second place at 34%, making property taxes the largest revenue source for state and local governments.[62] However, for many local governments, property tax may be the only source of revenue, depending on local tax laws; for most localities, it likely is the most important in terms of percentage of revenues and raw dollar values. Thus, whenever outside forces limit property tax rates in some fashion, they limit the ability of the local government to collect the vast majority of their revenues.

The vast majority of states impose some limit on how much property tax can be collected by local governments – in fact, forty-six out of fifty states imposed some manner of restriction.[63] These can come in a variety of forms and sizes, varying from state to state, but the two that appear most common involve limiting either the rate of taxation or the amount of tax revenue a given tax can generate. For example, Texas school districts are limited to a specific rate of taxation – no district can impose a property tax greater than 50 cents per $100 of assessed value.[64] This can also be rewritten as $5 per $1000 of assessed value – an expression referred to as a millage rate (with one mil being a tenth of a percent).[65] In Texas' case, this is a simple rate limit. Regardless of how the property values change, the school districts are able to impose a flat rate on property values, but cannot exceed this value (unless special permission is somehow granted or the law changes). This also does not mean that every district must operate at that rate, and many can operate under this limit; however, taxes that exceed this limit can only come from override votes by the people.[66]

Another type of limit, one that constrains states far more, comes in the form of an increase limit. In the state of Washington, for example, local governments cannot normally collect more than 1% more revenue than in the previous year. This does not apply on an individual level, but is spread out over the entire tax base; however, this limit does constrain Washington localities in how much they can count on from year to year. Override mechanisms exist, such as by popular election, but these also cannot be counted upon.[67] Thus, Washington exists in a state of incrementalism – the state's local governments cannot exceed certain limits from year to year, and thus need to maintain a certain degree of equilibrium in how much they take in AND how much they spend. Under the original Taxpayer Bill of Rights amendment, Colorado governments at all levels returned $2 billion in excess taxes above the constitutional limits to taxpayers, either directly or through lowering future tax bills, when collected revenue exceeded the growth limits set by the amendment.[68]

In addition to revenue limits, states can limit how much their localities are able to spend from revenue sources. In some cases, this forces additional funding into rainy day funds; in other cases, this can even require the rebate of revenue to taxpayers (especially with regards to property tax). This means that a given government can be certain in how much money they will have to spend from year to year (assuming the economy remains the same), but also means they know that they have nothing left to fall back upon if expenses suddenly skyrocket; when we consider that localities probably have to also have some kind of contingency funding (i.e. extra money for city vehicles in case the price of gas skyrockets), local governments may be further limited in how much they can spend in this situation.[69]

Coordination issues also provide problems with regards to taxes. Most parts of the country report to multiple local entities for different things, and thus pay different taxes to each body in addition to state and local income taxes. Keeping the schools separate from the water district, the hospital district, and the general oversight of the city government may allow the school district more latitude to make decisions without having to report to a less informed bureaucracy; however, it also means that the school in question must compete with the other forms of local government for resources. Each additional division between different components of government means that taxation policy is similarly fragmented; this means that local politicians in a particular government must consider other, overlapping local taxes when considering raising their own.

For example, in the thirty largest metropolitan areas of the United States, the average median home price to median income ratio is 3:1; now, this is obviously possible due to mortgages, allowing people to buy homes over time rather than pay for it all at once. However, property taxes are not figured in to mortgage payments; owning a home in a relatively expensive city can become even more expensive when you have to pay a portion of that home's value annually.[70] Now imagine that four or more separate entities are taxing out money from homeowners each year, without any centralized control. This can quickly get out of hand if all of the local governments tax at the highest rate permissible, depending on how high those limits are, especially for those homeowners who make less than the median income.

Even if the rate limits are somehow designed to prevent the tax burden from becoming too high to actually manage, having multiple localities with high tax rates may prevent the tax base from growing by discouraging people from moving into the area, and new taxes may drive away those who would pay them. For instance, in New Jersey, a state-wide "millionaire's tax" instituted in 2004 was estimated by the state to have contributed to 20,000 additional individuals leaving the state. While that number would not normally be a cause for concern, given the wealth of the individuals in question this cost the state about $2.5 billion in revenue, something the report considered "small but significant,"[71] and offsetting the revenue boost that the tax actually brought in. Further, the study also contended that similar effects in other states would lead to similar effects internally – increasing marginal tax rates can lead to an offset in revenue as the tax base moves away, and there is no way to account for how many people and businesses such taxes will keep out of the state (and hypothetically city) in question in the future.[72] Thus, local governments must be careful even when their proposed taxes do not exceed the limits set for them, so as not to create situations where potential taxpayers choose to avoid living in a given area. To that end, lawmakers may seek to use bonds to avoid large tax increases that could drive away current and potential residents, while simultaneously improving the quality of the governed area to further entice newcomers.

Finally, these limits are not equally applied to all governments. Texas is one of the states that limits how high the tax rates can be in a municipality or special district. However, counties are exempt from state limitations on taxes, allowing them a greater deal of flexibility in how they structure their tax packages. This can be encouraging for investors in county bonds in Texas, since the taxing power guarantees a return on investment. Depending on how much the county governments need to do, however, they may be able to set the rates so high that school districts and cities in the same area cannot raise their taxes high enough for their own purposes.[73]

Why Use Bonds?

Given the restrictions of bonds, why would a government choose to pursue bonded debt as an alternative to taxation? Certainly, some projects are too large to fund out of a given year's tax base without cuts elsewhere, but when funding smaller, revenue-fundable projects, why do governments find bonds more acceptable than tax hikes?[§§§]

One possible reason is perception. Tax increases are not popular policies, particularly in the eyes of those who would pay them. Although Gallup finds support for raising taxes on the rich, overall opinion trends favor lowering taxes in general across the nation, even if it means a cut in services; in addition, those polled reported a personal

[§§§] We should also note that some bond packages include raising the taxes as part of the plan to pay for them. However, these increases tend to be smaller than the taxes needed to fund a project without bonds.

sensation that the current income tax is too high for them.[74] Furthermore, though questions regarding property taxes across the nation are not asked often, local property taxes are generally regarded as the most onerous and the least fair – in 2005, a Gallup poll on the matter suggested that twice as many people saw their property tax as the worst tax they had to pay than thought their income tax was the least fair.[75] This perception has a long history in the United States; similar numbers can be found in research conducted in the 1970s by the federal government, with the opinions then being discussed as nationwide, with far less variation based on location than expected.[76]

Also, since you can only use bonds for capital projects, many of which are designed to last a long time, bonds carry a perception of fairness – those who live in the community now are not forced to pay for items they may not enjoy the full life of, and those that come into a community are able to pay their "fair share" of projects that were started before their arrival.[77] This may be especially true in cities and states where voter approval is required to pass either a bond or a tax increase; whether this it due to a state law requiring such a vote in all cases (such as Colorado's Taxpayer's Bill of Rights Amendment)[78] or because the government in question would exceed the limits set by the state (such as when Central Health held an election which increased property taxes to double the constitutional limit),[79] local governments may seek to issue a bond which includes a modest tax increase rather than ask voters to approve a large tax hike.

Given such opinion against property taxes, which are the main source of funding for local governments, it makes sense that the governments in question would seek to minimize the local tax burden as much as possible, or at least avoid raising it noticeably to pay for projects. And yet, when it remains one of, if not the, biggest sources of revenue for state and local government, this limits the options available to those local governments in question.[80] Thus, bonds may provide the ability to avoid openly raising taxes to the level necessary to pay for a project, even if such tax revenue is an option. This is especially important in situations where the government in question has to call for elections to support new taxes as well as new bonds – bonds may be an easier sell to voters, even if in the long run they become more expensive than raising the tax would have been.

Bonds also may be sought in times when they are not necessary to help prepare for times when they are. In 2011, Central Health, a recently-created local government in Travis County, sought taxable revenue bonds for a set of construction projects to help build new facilities and renovate existing ones, despite the presence of existing reserve funding. The low interest rates and the district's positive financial situation and outlook meant that paying down the bonds over the next fifteen years would be relatively easy; even more importantly, however, the District, only a year old at the time, lacked any credit rating, and would thus have trouble securing future financing for larger projects. By tackling a smaller set of project, funding-wise, and making a move to acquire financing when the market was favorable, Central Health were able to receive a AAA rating from Standard and Poor's, the highest credit rating possible, which will help them secure future financing on larger projects should they ever need it, while putting themselves at less financial risk in the future.[81] Other new governments may seek bonds they otherwise would not need in similar situations.

Why *Not* Bonds?

Why would a local government choose to tax their own citizens rather than take out bonds? The big reason there seems to be risk. Raising taxes certainly carries a political risk to lawmakers; indebting the government poses an economic risk. Defaults on municipal bonds are rare; as of 2007, Standard and Poor's calculated that less than one percent of municipality bond offerings were defaulted on, compared to 13% of corporations bond offerings. However, the economic times since then have changed, and bonds that fail to bring economic benefit can harm the city. In 2011, both Jefferson County, Alabama and Harrisburg, Pennsylvania filed for bankruptcy, largely related to earlier defaults on bonds. In fact, the defaults prior to 2000 were negligible compared to those that came after, thanks to economic downturns. Thus, modern governments may see bonds as risky when other options exist.[82]

Tying into this, credit ratings may make bond sales less profitable for a given government. Investors see lower credit ratings as signs of risk, especially since lower ratings can reflect past defaults,[83] and bond sellers must use higher interest rates to entice buyers.[84] However, investors also consider factors beyond the local government in question; defaults, downgrades in credit ratings, and economic crisis in general in nearby governments can lower investor confidence in a government's bonds, even if that government is traditionally solvent. Detroit's bankruptcy forced many local governments in Michigan to reconsider plans to sell bonds,[85] even those whose credit ratings are considered "very low risk."[86]

Taxes may also be preferable to bonds when the timing fails to favor a bond election. As mentioned, multiple state constitutions limit the dates that elections can be held; this ranges from Georgia, where bonds can be included on four election dates each year,[87] to Colorado, where the Tax Payer Bill of Rights limits most bond elections to November.[88] If a given year is not conducive to a particular bond election, and the government has no options to schedule the election on an alternative date, a city may raise taxes slightly to buy time until a more appropriate election arrives, or else hold off on any projects that require additional funding.

Perceptions cut both ways; while raising taxes is politically risky, governments face hard sales when advocating debt for seemingly minor projects. According to a former public finance banker of twenty years, an appropriate debt package generally requires at least one large item that the public universally recognizes as a public good – a new school, lane extensions, or a new firehouse, for example. Without the larger item to rally the voters, smaller projects fall flat more easily; even essential projects can fail if they seem frivolous. Thus, governments may favor higher taxes when lacking such a massive item.

Failure of Bond Elections

Increased taxation no longer seems to be the solution to every need for additional revenue in general, but this information does not address specific instances when tax increases simply are not viable. The contents of bond packages show how much certain items can cost, and how difficult it can be to actually raise that kind of money for a given district. For example, Eanes ISD, a school district in Austin, Texas' metropolitan area, recently held a bond election which called for almost $90 million in construction and renovations, simultaneously proposing a tax increase that would average out to $10 in additional property taxes on $500,000 homes per month to pay for the bonds over time, or $125 additional dollars a year.[89] However, the election in question failed. That leaves the question of how much the school district can pay for from the package out of tax revenue; the answer, apparently, is almost none of it. The failure of the bond means that many of the projects, especially the major ones, will go unfunded. The single largest item on the bond agenda, a new elementary school designated to replace an aging facility, was estimated to cost $38 million to build, from land purchase to completion of the building.[90] That item is now completely off the table as far as the district is concerned, until a new bond can be passed in the future.

This raises the question of what happens when a bond election fails, which itself is important when attempting to judge how much fungibility the bonds actually provide. As mentioned above, the first option in the event of a bond failure is to reoffer a similar (but usually smaller) package in a following election. This is generally simpler than calling for an initial election since most of the hard work has been done already; the district in question already has some kind of package set, and needs to simply determine what not to include in the new election. In 2012, Austin city had seven bond measures on the ballot, leading to only one failure – a $78.3 million affordable housing bond. The following year, after reworking the ballot language and lowering the measure to $65 million, in conjunction with a stronger campaign by outside housing activists and weaker opposition, the city managed to get a similar bond package passed.[91] While the new bond obviously could not go as far as the initially desired measure, it still means that most of the planned projects will receive funding.

A second tactic, which is mainly a short-term one, involves using tax money to handle some of the smaller and more urgent matters. This can involve raising taxes to create more revenue, or redistributing funding from elsewhere in the budget (usually the MNO portion). For example, in the failed Eanes bond, the plan called for the replacement or renovation of HVCA units at six of the schools for a total cost of $10,000,000.[92] Obviously, not all of those projects will receive funding; however, in Texas, proper HVAC functionality is considered an essential item. The standard Austin apartment lease calls for emergency repair status with regards to any HVAC malfunction; when dealing with schools where students will spend a third of their day, it also seems likely that HVAC functionality is a top priority, meaning that at least some renovation of the systems will likely be funded in order of priority, especially where the replacements would cut down on future maintenance needs. Similarly, other small items that are considered important or essential may also be dealt with from the MNO budget. However, this leaves less money to pay school employees, including teachers, administrators, and maintenance staff.

The final option is the one most contingent on outside factors. As mentioned, bond money can be left over from previous elections. Though this money is limited, so long as it falls within the 15% effective limit, this money can persist until it is spent. When a failed bond falls into an issue area that a previous bond with excess funds covered, those excess funds can be put to use in paying for items on the failed bond.

Although it is mentioned last, this is usually the first option that lawmakers look to in order to find funding for a failed bond's projects. The leftover money from such bond sales is already being paid off in any event, so it makes sense to go ahead and use it if nothing has come up to that point. Furthermore, this can be a way out of an unexpected over-sale of bonds, leaving a government with more money than can be spent, though such situations are rare. However, as mentioned, leftover bond sales require a confluence of events in order to manifest as an option. Firstly, there needs to have been a previous bond with leftover money, and that bond must fall into a category that can apply to the project in question. Atlanta cannot redirect leftover transportation money into housing, nor can the Charlotte school district lend a city its leftover bond funds to help with utilities repair. With single-issue districts, such as hospitals and schools, the bonds can generally be written so that they can apply to anything that that district may need in the future; but, for cities and counties, this means that failure to pass bonds repeatedly in a given issue area can lead to a lack of future funding for projects related to that issue.

How Do the States Differ?

Up to now, this paper discussed the generalities of how the bond process works, and has presented some examples to answer the question of whether or not bonds are pursued to create fungibility for the governments in question. The question itself may not be fully answered in the course of this work. However, we can also begin looking at how the states – and the governments within states – vary with regards to their handling of bonds, such the laws that they put in place regarding bonds, as well as how they pursue the issues of taxation.

What These Cases Tell Us

I have outlined multiple different examples of how states approach bonds and debt, as well as how they approach taxes. But the real question remains – what can these states tell us? I devoted the time to these cases in order to outline a possible taxonomy with regards to measuring how states (and municipalities) handle bond issues. In each case, I outline the state's overall rules, and then detail those rules with regards to three categories – transparency, taxing authority, and freedom to pass bonds – and how these factors contribute to the choices for lawmakers exists in raising taxes or issuing bonds.

These states were not chosen randomly, but rather are a convenience sample based on available information. The choices also represent the vast range of differences that the states can have regarding issues of bond and tax policy, ranging from Illinois' freer home rule policies to the strictly-controlled policies of Alabama. There may be more open or stricter policies; however, the ones presented appear to represent the various options along with spectrum.

New Jersey

New Jersey is one of the smallest states in terms of area, but not only does it have the eleventh largest population of states in the nation, it also possesses an incredible population density, with approximately 1210 people per square mile of state area making it the densest state in the Union.[93][****] This makes New Jersey a very interesting state to study with regards to public works projects and the funding for them – after all, there is very little area to make such works, and yet the state has a great deal of people using each

[****] If New Jersey had that density and were the size of Texas, it would have a population almost as large as that of the entire United States.

and every service, meaning that they may require extensive renovations to keep up-to-date.

At the state level, New Jersey collected $27 billion in tax and fee revenue in 2013, a growth of 6.8% from 2012.[94] This comes to an approximate average of $3055 in taxes per capita. In addition, local governments collected $2893 per person in property taxes, which ranks the highest in the nation, and which comes out to an additional $25 million in taxes collected by local entities. With additional taxes from other sources, the per capita tax rate in New Jersey comes out to $6675, a tax burden of 12.27%.[95]

The New Jersey Department of Treasury maintains an Office of Public Finance, which keeps track of state debt[96] – bonded debt accrued by legislative action, and by state agencies issuing their own independent bonds, as well as non-bonded debt and obligations that the state has accrued, such as pensions. As part of this mission, the OPF publishes an annual report of the state's debts, including the sources of debt (i.e. which bond issuances money is still owed on), how much the original debt was authorized at, and how much is still owed. Unfortunately, the OPF does not keep track of local governments' debts and bond obligations, and no other central authority seems to keep track of the lower governments' debt, meaning deeper research into New Jersey will require looking at each city or other local entity on its own.[97]

This does not mean that the state level data cannot be useful, however. For one thing, the report provides us with a glimpse into how the New Jersey Legislature views the purpose of bonds. For example, we learn that New Jersey expects a State Capital Improvement Plan to be filed annually, which schedules future public works projects and the bonds to pay for them, if any. This suggests that the state annually seeks bonds, a fairly frequent undertaking. In addition, we also learn that the state and state agencies have almost $35 billion in bonded debt that it owes as of June 2013, but that half of that debt is backed by "dedicated revenue," meaning that they are likely revenue bonds. Even so, the state still owes $1985 per person in general revenue-backed debt, and almost twice that for all bonded debt, far beyond what it takes in from taxes each year. In addition, the state added over $900 million in new debt, both from new bonds and from interest, since the past year.[98]

One further point of interest exists regarding New Jersey. Not all states have to seek approval to pursue new state general obligation debt, though the practice is almost universal among lower levels of government. However, in New Jersey, new debts greater than one percent of the annual budget must be approved by the voters. Until 2008, this did not apply to bonds issued by state authorities that were autonomous of state and local governments, such as the New Jersey Transit Authority; these entities could "authority bonds," which function similar to revenue bonds but which can be backed by general taxes rather than just the revenue generated by the agency.[99] This changed after the 2008 general election, however, when voters approved a constitutional amendment requiring voter approval for authority bonds which derive backing from state funding. This provides a possible natural experiment to see if bonds from before and after this period are substantively different in scope.[100]

Very little information has been found as yet as to the overall limits on New Jersey's local bond rules. However, a great wealth of information exists regarding the bonds from New Jersey Schools, thanks to the New Jersey School Boards Association, who provide a great deal of transparency for school bonds across the state, including rate of passage from year to year. In addition, New Jersey requires that almost all school budgets be approved by the local voters, and the board keeps track of the information regarding those passages as well.[101] Passage of bonds is not guaranteed by any stretch, and varies widely from year to year; in March 2012, for instance, voters in four townships rejected $23 million in construction projects, and only one $1 million request from Little Silver schools was approved (of which a quarter was already covered by an existing fund).[102] Conversely, in 2000, 79 of 100 bond ballot measures were approved across the state.[103]

- **Transparency:** While it can be difficult to find viable local information, the State has at least set up its own website that details how it handles debt (and taxes). This, at least, allows some insight into how New Jersey functions.
- **Tax Income/Power:** Though they may not be spending it properly at all times, New Jersey has a great deal of tax revenue to work with. That said, New Jersey also has been missing the mark according to its own internal reports, meaning that it may have to rely more heavily on bonds in the future, but also raises questions as to whether or not the state can afford those bonds.
- **Bond Authority:** New Jersey seems to have the ability to pass bonds without consulting voters, for the most part, and thus the only limit to the state's debt is the government's prudence. Local governments, to the contrary, need to seek voter approval; if the passage rates on school bonds are any indication, many local

governments in New Jersey face a challenge in convincing voters to support their bonds. This may become more difficult in some communities; Atlantic City, for instance, had its bond rating "junked" due to a weaker tax base, which will make it harder for the city to seek further bonds to try and revitalize the damage time and changes in the law have done.[104]

- **Choice Points:** For local lawmakers, the main choice points regarding bonds are standard, as described through the paper – the choice to pursue bonds over taxes are not restricted by special state policies, and no outside factor seems to legally limit how much they can seek in bonds; thus, their choices are mostly based on local conditions. However, certain areas have suffered due to the economic recession and damage from natural disasters, leaving their options more limited. In addition, the higher overall tax rates may stymie bond projects that require voter approval. For the state, the choice points lie solely in the legislature, allowing them to act freely; state agencies must seek voter approval for certain types of bonds, which may influence how they seek financing (if they do at all).

Illinois

Illinois' average resident paid $4658 in taxes in 2011, with $1881 being property taxes.[105] Illinois does not have a central database of bond information.

Illinois law creates two different classes of government. Most local governments are required to abide by statutory limitations set by the state; however, certain Illinois governments bear the "home rule" designation. Home rule cities (as well as Cook County) either passed a referendum to declare themselves home rule, or else automatically received the designation by having more than 25,000 residents; these districts are constitutionally exempt from certain state laws, and can nullify the effects of county laws in the municipal borders. This autonomy allows these municipalities to justify their own specific laws.[106]

- **Transparency:** Illinois offers no known database of bond information.
- **Tax Income/Power:** Non-home rule local governments can be limited by the Property Tax Extension Limitation Law (PTELL), a law that allows referenda to limit the growth of overall property taxes to the growth in the CPI or 5%, whichever is greater.[107] Not every local government has such a law, but every government that has put the referendum on the ballot has passed it. This limits local taxing authority. Home-rule governments are not under any obligation to honor the PTELL; they can choose to cap their own taxes, but the city councils in each home rule district can choose to ignore these restrictions with a simple vote.[108]
- **Bond Authority:** Statutory restrictions limit non-home rule districts to a certain percentage of the Equalized Assessed Value (1/3 of the market value of all taxable property in that district) in outstanding principles, with the percentage based on the type of government.[109] Home rule districts can be limited by the state government in special cases, but normally have free reign to seek bonds, and are only limited by city codes.[110]
- **Choice Points:** Most local governments must abide by voter-set limits with regards to taxation; this may influence the decision to pursue bonds, especially

when contrasted against a major tax increase. However, home rule governments, as well as the state, only have to abide by statutory limits set by the body pursuing the bond. This means that they have additional options when pursuing either taxes or bonds; if their local laws prevent the government from getting what it wants, said government can merely rewrite the laws without any direct check by the people.

Alabama

Alabama's tax burden in 2011 was 8.3%, meaning that the average resident paid $2886 in state and local taxes, including $540 in local property taxes, the lowest property tax rate in the state.[111] With 4.8 million residents, this means that the state and local governments collectively took in $13 billion dollars this past year. Unfortunately, no central database exists to determine how much money Alabama owes in bonds, at either the state or local level.

Like many states, Alabama has, as part of its law, the authority to issue GO bonds. However, this authority is not universal, nor is it statutory. That is to say, it is not enough for the Alabama legislature to pass a law for a bond to come into existence, or even to call for a referendum. Rather, it appears that the authority to issue state GO bonds must come from an amendment to the state's 1901 constitution. According to Section 213 of the constitution, the only debt that can be created by or against Alabama as a state are in times of invasion or insurrection, and even then only if two-thirds of both houses of the state legislature approve of it. The only exceptions provided for in the constitution are that a maximum $300,000 loan can be negotiated by the governor with legislative approval to “meet the deficiencies of the treasury,” with no future loans authorized until the initial one is not paid off, and bonds that are used to refund bonded debt held at the time the 1901 constitution was passed.[112] Thus, in order for the state to enter into bonded debt, it must pass a constitutional amendment, which includes voter approval of the measure. This does mean that we can determine the principles of all state bond sales, even if we cannot locate how much they still have left to pay on principle plus interest.

Local governments (referred to collectively as “municipal corporations,” have standard restrictions set in the state constitution regarding the creation of debt – that is, any general obligation bonds passed must go through the voters for approval. Furthermore, the local governments are limited in how much debt they can create; all municipal corporations can have up to 20% of the assessed value of property inside their jurisdiction in debt, and those with a population of less than 6000 can have an additional three points worth of funding for waterworks, power plants, sewers, and street improvements.[113]

I bring up Alabama in this to show a state on the far end of the spectrum from one such as New Jersey – low taxes, a smaller, less dense population, and a very different method for approving state bonds, even though local bonds function under very similar processes. This could be viewed as an example at the opposite end of the spectrum from New Jersey, at least as far as the state-level matters go.

- **Transparency:** We can discover which state bonds were ratified into the Constitution, and how much they initially were worth. However, there is no easy way as yet to determine how much is left on the bonds, and how much the localities serve

- **Tax Income/Power:** It is uncertain if Alabama can draw on more taxes or if it chooses not to. That said, they do also have a sizeable amount of wealth in recent years due to oil and natural gas in their Gulf Coast waters (or did prior to the Deepwater Horizon disaster) which constitutionally is used to pay for certain projects.[114] Further, the Alabama Code limits how much tax each municipality and county can raise; a county cannot change its sales tax in either direction from what the law has set for it.
- **Bond Authority:** The local governments have a standard form of passing bonds, but also have limits in place as to how much debt overall they are allowed. The state government, on the other hand, must pass all bonded debt through amending the constitution, which not only requires consulting the public, but severely limits when they can seek these bonds. It also means that the state must make these bond events even more public than it may normally; it is possible to miss a regular bond election in an odd-numbered year, but any amendments to the state constitution will be noticed on the ballot and by the voters.
- **Choice Points:** Alabama's state government may have the strictest rules in the country for a state pursuing bond debt, and fairly strict rules for pursuing bonds locally as well. The need to amend the constitution puts all bond debt in the hands of the voters, whether local or state, and may be preventing (or at least

discouraging) the governments of Alabama from pursuing significant levels of debt.

Texas

Texas is currently the second largest state in both area and population, having passed New York in the 2010 Census. Texas has no income tax, along with Alaska, Florida, Nevada, South Dakota, Washington, and Wyoming. Conversely, however, the property tax owed per capita is $1557, and each person owes $3088 in taxes overall; while these values exceed states such as Illinois or New Jersey, the wealth disparity causes these taxes to represent relatively larger tax burdens (especially the property taxes, which are high for the property value).[115] All told, the state took in $47 billion in taxes in 2013, up 8.4% from the past year.[116]

Texas appears to be unique in how well it tracks debt in the state. The Texas Bond Review Board acts to track all bonded debt held by governments in Texas, including all local bonds, and including a breakdown of the original principle, how much has been paid thus far, and how much is owed (including interest). The Review Board also makes known the general purpose for each bond offering, though it does not keep track of the specific uses of the bonds.[117] The TBRB does not, however, act to regulate bond usage or elections (except for drafting rules for private activity bonds), but rather facilitates those entities that would seek to fund projects with bonds, and to educate them and the public as to the state of Texas' debt.[118] As previously mentioned, it is the Attorney General's office that approves the election of new bonds in the state.

The state of Texas itself owes $24 billion in GO bond debt,[119] and $50 billion more in revenue bonds.[120] Collectively, the local governments are $200 billion dollars in debt as of 2013.[121]

- **Transparency:** Texas is the only known state to maintain a database of bonds. Although the MSRB's EMMA database records data from across the country, EMMA requires that you know the specific issuers you wish to learn about; you cannot filter EMMA for different types.[122] Texas' Bond Review Board, conversely, allows you to sort by different types of governments, allowing those curious to know about school debt in Texas to find out only about school bonds, and specifically the principle and remaining debt owed. This makes Texas the most transparent state in the nation at present.
- **Tax Income/Power:** Texas more than manages to stay solvent even without an income tax, but the overall tax revenue for the state is low relative to its size. That said, we also need to take into account the lack of professionalization in the state legislature; since the legislature meets very infrequently, the state may not carry out as many projects relative to the local governments as in other states. Conversely, the limits on taxes make it harder for local governments to raise revenue through alternative means. That said, if a government has room to increase its taxes up to the tax cap, they can pursue such increases without asking for permission, meaning that frugal districts have more options in the future.
- **Bond Authority:** Texas is one of the few states where a state figure approves all bonds; for the local governments, this puts an extra burden to justify the need for

the bonds, as well as the financial conditions in that jurisdiction. The local governments are also bound by rules limiting how much they can tax, and thus how much they can reasonably bond at a time.

- **Choice Points:** Texas' system resembles the traditional system regarding taxes and bonds throughout the nation, with one major difference- the involvement of the attorney general means that local governments have an additional actor to consider in their plans. No statistics are given regarding rejection by the attorney general's office, but this may reflect more careful planning on the part of the governments seeking to issue debt – they are not rejected because the packages in question are well-constructed. The added role of a state figure does not seem to keep local governments from issuing a large quantity of bonds, as Texas perennially ranks among the top bond issuers by amount.

Future Research Questions

This project only scratches the surface regarding research into bonds. Many other issues remain; while some qualitative analysis has been done regarding the effects of different laws on bond issues, more in-depth research can be conducted regarding the effects of particular types of policies and governing situations. In-depth research into the latitude offered to different types of local governments, the effects of greater autonomy on the choice to pursue debt, and the effects of bonds on the economic growth of governments represent three potential avenues of future research.

However, the largest research issue remains the problem of data; without comprehensive information on bond issuances and bond policies for each state, any such research faces limitations. For the latter, research may only require a few dedicated individuals examining state constitutions and codes in-depth to develop a road map on bond policies. However, the removal of relevant data from the available datasets after the maturation of bonds means that researchers cannot completely analyze the fiscal impacts of past bonds with ease. Even if scholars began cataloging EMMA's records completely from tomorrow forward, the data in question would only include bonds which are not yet mature, missing decades of bond issues by local and state governments and agencies. In order to build a fully comprehensive record, one of two things must happen. The first, and best situation, would be to receive from the SEC all bond information, whether currently listed in EMMA or not. This data may require significant organization, but the data would be there to be organized.

However, if the SEC cannot or will not provide such data, researchers face a daunting challenge. The only possibility of success would require a coordinated effort by political scientists and policy analysts from around the nation examining all local bond sales, city by city, county by county, and government by government, until the full scope of bonds stands revealed. Such a task may require multiple academics from each state, and would take years, but it may be the only way to build the database necessary.

Conclusion

As with the proverbial iceberg, we only see the smallest portion of the role bonds play in politics, and the role of politics in the decisions to pursue bonds. However, this examination does bring to light the importance of understanding bonds and all the elements of society they touch upon – which may well be every part society. Bonds are not simply ballot items put to the voters for approval or rejection; they evolve from months of research and preparation, and often represent a political risk on the part of the decision-makers. They also represent what many would consider an essential part of our public works funding, a component of government resources without which development would be impossible.

The political decisions to seek bonded debt vary from state to state and situation to situation; however, many of the issues remain constant even across divergent cases. Tax limitations, both legal and practical, prevent governments from taxing their way out of every desire for appropriations or discretionary spending. Public approval can influence not only whether a bond passes, but whether it hits the ballot. And the data needed to fully study this issue remains uncollated, though it may well exist.

Bonds represent risk to society, in the form of debts our future generations must pay; they also represent the possibility that such a generation may enjoy benefits greater than the past could provide on its own, and that it may be in a better position to pay those debts. Both the risks and the rewards must be studied; both possibilities deserve to be understood.

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